

# California Association of School Business Officials



## The Decision to Issue Debt



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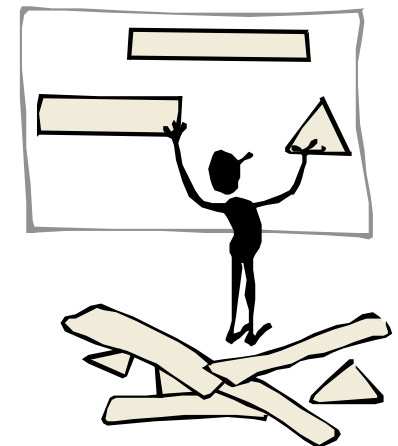
# Return on Our Investment

- **We don't usually think of issuing or administering debt as an "investment". However, every endeavor that we engage in is at least an investment of our time and energy, and may also involve other resources for which we are responsible.**
  - **Let's get the most out of what we do!**
- **All school business officials should have a comfort level with the concepts, the terminology, the math, and how to handle the "players" when it comes to debt financing.**
  - **Every transaction should be a good deal for kids!**

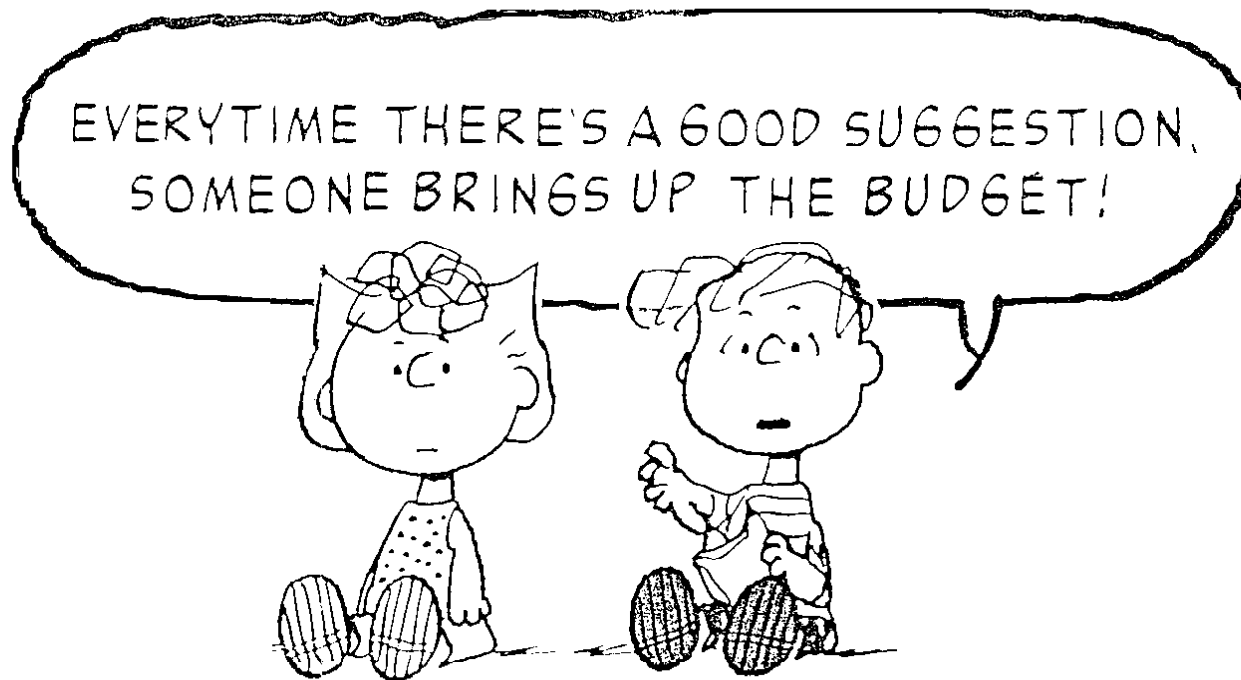


# Today's Return on Investment

- Hopefully, everyone here will feel more knowledgeable and confident with the topic of debt by the end of the day.
- There may even be reason to question past practices. That's okay! We're all here to learn, and to take back to our districts improved practices.
- And, in some cases, debt the District has already issued can be administered better or restructured.



# It is Always About the Budget



# Debt Can Be Troublesome

- Debt is one of the top factors in fiscally troubled districts.



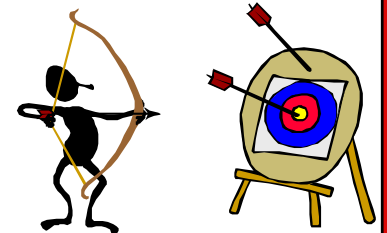
- School districts of all sizes and situations issue debt, and often with good reason.
  - The CDE estimates that \$6.5 billion is needed annually over the next 5 years for new construction and modernization.
  - In 2003, \$7.6 billion in long-term debt was issued for California schools, in 296 separate issues, (and that is just what is reported to the California Debt and Investment Advisory Commission).

# Common Sense is the Best Defense

## ■ Be forewarned:

- Debt transactions are often complex.
- Debt usually has long-term fiscal impacts which may not be well understood at the inception.
- There is a lot of bad information circulating, which results in poor decisions.
- Debbe's rules to live by:
  - » If it sounds too good to be true, it probably is!
  - » If you don't understand it, don't do it!

✓ *Our goal today is to increase your finance skills so your district can borrow appropriately and you can lead with confidence.*



# Math Isn't for Everybody . . . But it is for Us



# What is Debt?

- ***n.* something that is owed, or that one is bound to pay to or perform for another. (Random House Webster's College Dictionary, April 2000)**
  - Or simply put, a promise to do something in the future in return for something today
- **Debt happens (promises made and accepted) when there is good faith and trust.**
- ✓ ***“I will gladly pay you Tuesday for a hamburger today”.***  
***—J. Wellington Wimpy***





# Constitutional Debt Limit

## ■ California Constitution, Article 16, Section 18a:

– *No county, city, town, township, board of education, or school district, shall incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year, without the assent of two-thirds of the voters of the public entity voting at an election to be held for that purpose [...]*

» In other words, the voters must have a say!

» TRANs are not debt because they are short-term.

» Lease-purchases are not debt because they are contingent.

■ Obviously the 2/3 majority can now be 55% under the Prop. 39 election method, which will be discussed later.

✓ *Debbe says: “if there’s been no vote, the General Fund is on the line.”*

# Every District Should Have a Strategy

## ■ Strategy Considerations

- **How does borrowing fit into our mission (especially our facilities plan)?**
  - » **Long-term borrowing should be used only for capital projects and have a clear repayment plan.**
  - » **Short term borrowing should be very well defined and legally attached to a specific repayment source.**
  - » **The term of borrowing should match the useful life of the items being financed.**



# Debt Capacity

## ■ What is our debt capacity?

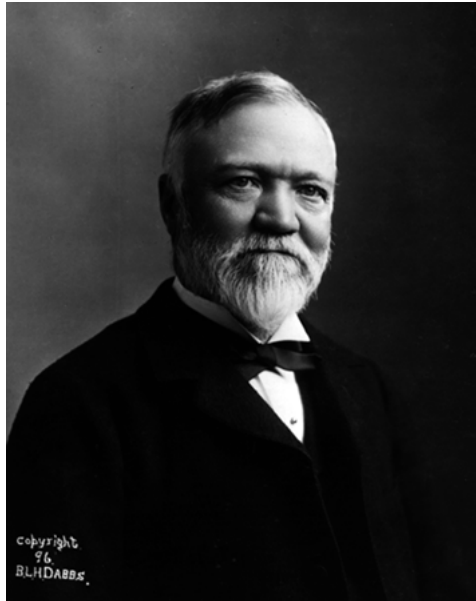
- General obligation bonds outstanding must be no more than 1.25% x assessed value for union districts, 2.5% for unified.
- How much debt service can the District's budget support (consider General Fund, special funds, growth trends, etc.)?
- OPSC defines “bonding capacity” in a variety of ways.



# Andrew Carnegie

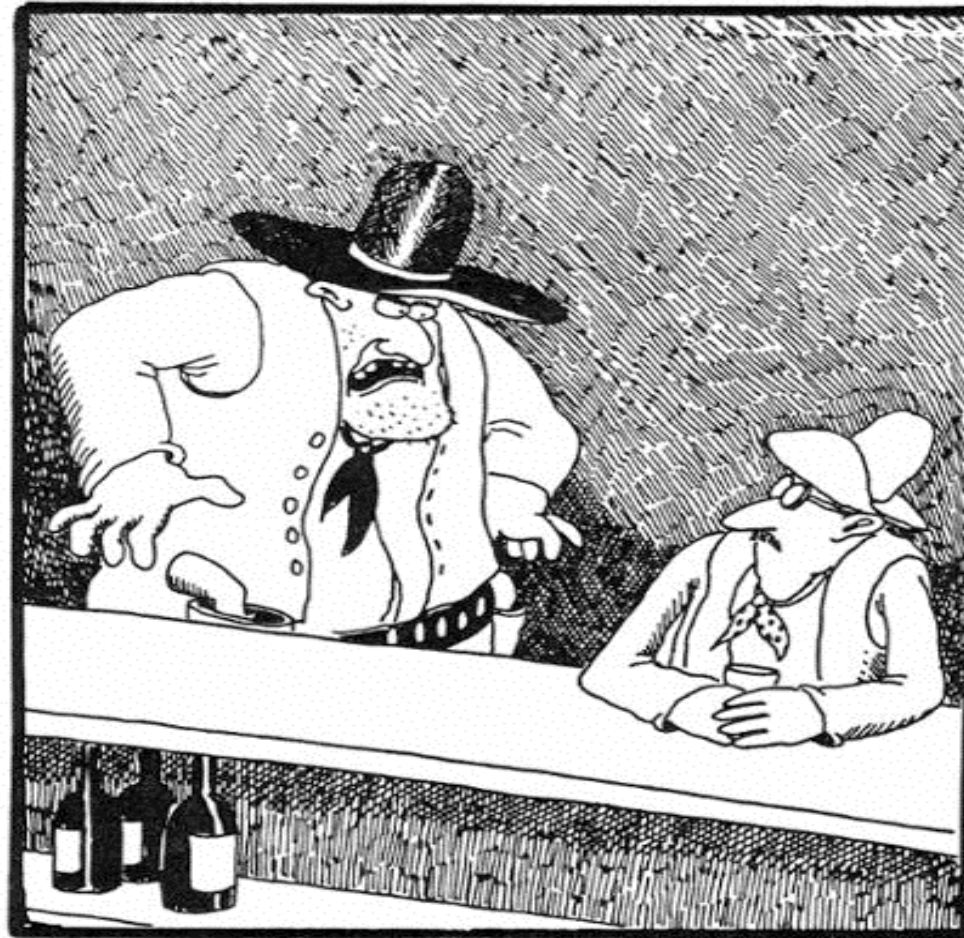
“

**Men don't plan to fail,**



**they fail to plan.”**

# Don't Make Decisions "Under the Gun"



"I asked you a question, buddy . . . What's the square root of 5,248?"

# Borrowing Money is Buying Money

- Money is the ultimate commodity
  - It can be exchanged for any commodity
- The only difference between the money of one lender versus another is price
  - Up-front (points or costs of issuance)
  - Over time (interest)

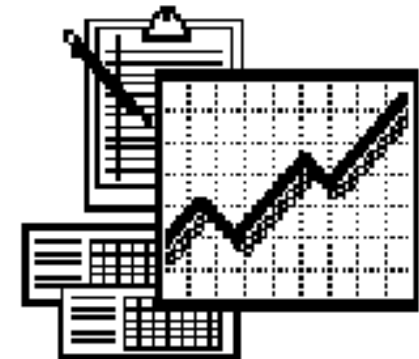


# Two Reasons To Borrow Money

## ■ Cash Flow



## ■ Economic Advantage

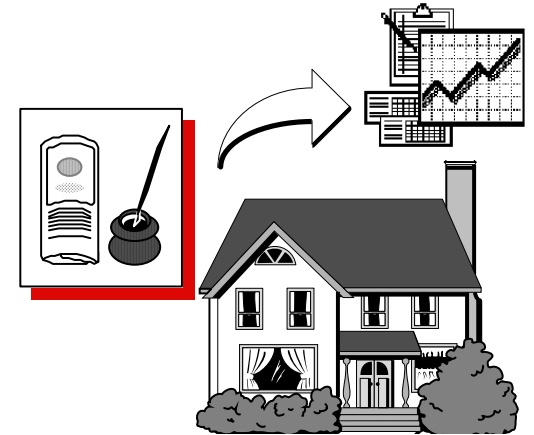


# Borrowing as a Cash Flow Strategy

■ Borrowing for school facilities is the same as borrowing for a home. We borrow because we don't have the money today, but we will have the money over time, and we don't want to wait for the facility.

- It can be appropriate to borrow for capital items with asset value.
- It is not appropriate to borrow for operating items.

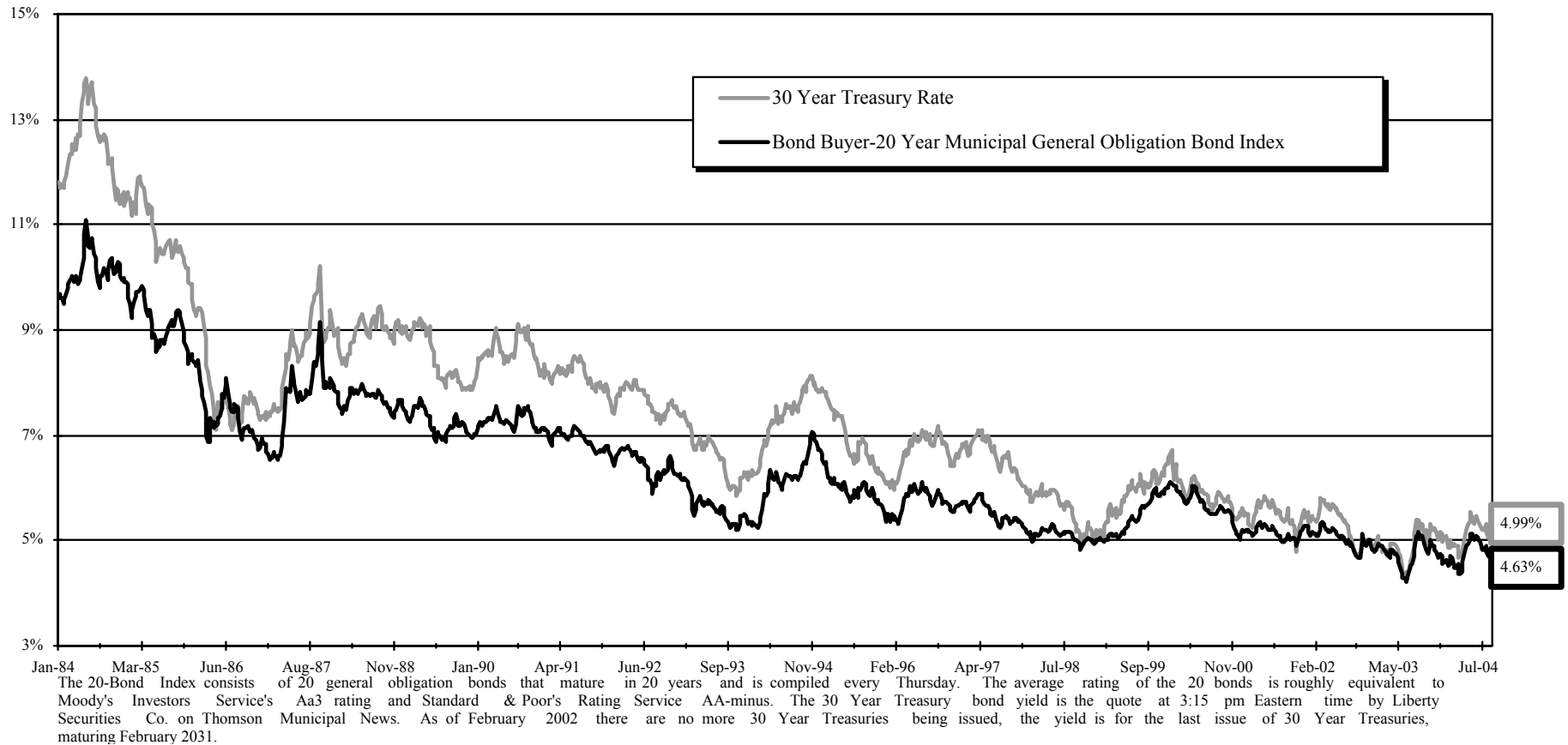
» Don't put the groceries on the Visa card.





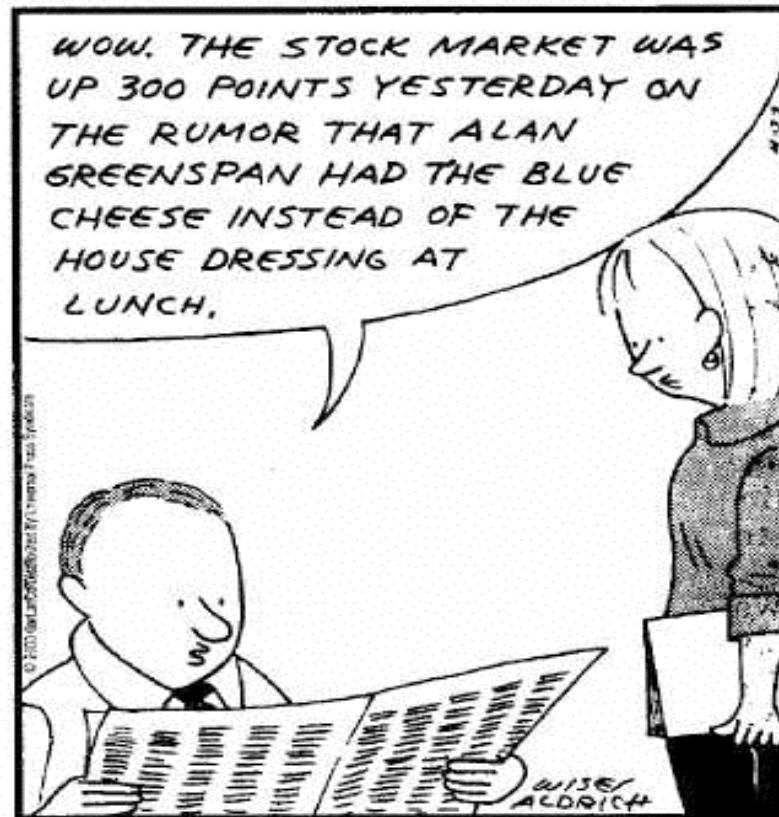
# Borrowing as an Economic Strategy

**The Interest Rate On Tax-Exempt Municipal Bonds Is Almost Always Lower Than The Rate On Taxable Treasury Bonds**



# Financial Markets are Unpredictable

## ► REAL LIFE ADVENTURES



Imagine what would have happened if he'd ordered the coleslaw.

# Things to Keep in Mind When Borrowing

## ■ Borrowing is a Means to an End

- Implement the borrowing in a style consistent with the District's overall approach
- Design the borrowing to meet the District's goals

## ■ Obtain Independent Information

- Readily Available Sources
  - » Local newspaper
  - » Wall Street Journal, Internet
- More Extensive Research
  - » Standard & Poor's, Moody's, Bloomberg
- Experts
  - » Don't abandon one's own judgement
- Colleagues
  - » Consult, but filter - what works for one district may not work for another

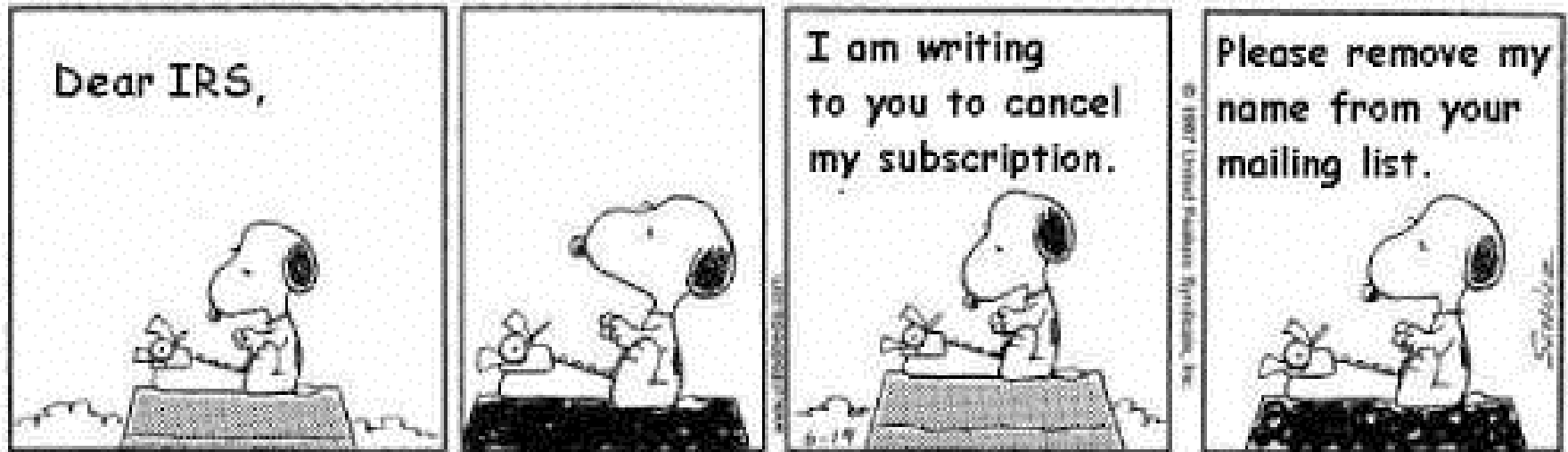


# Regulations and Oversight

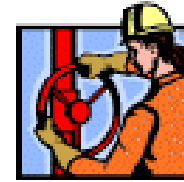
- **County Offices of Education and County Treasurer**
- **Internal Revenue Service (IRS)**
- **Securities and Exchange Commission (SEC)**
- **Local Citizens/Taxpayer Groups**
- **Fiscal Crisis and Management Assistance Team (FCMAT)**



# Regulation and Oversight Are Not Optional



# Safety Valves



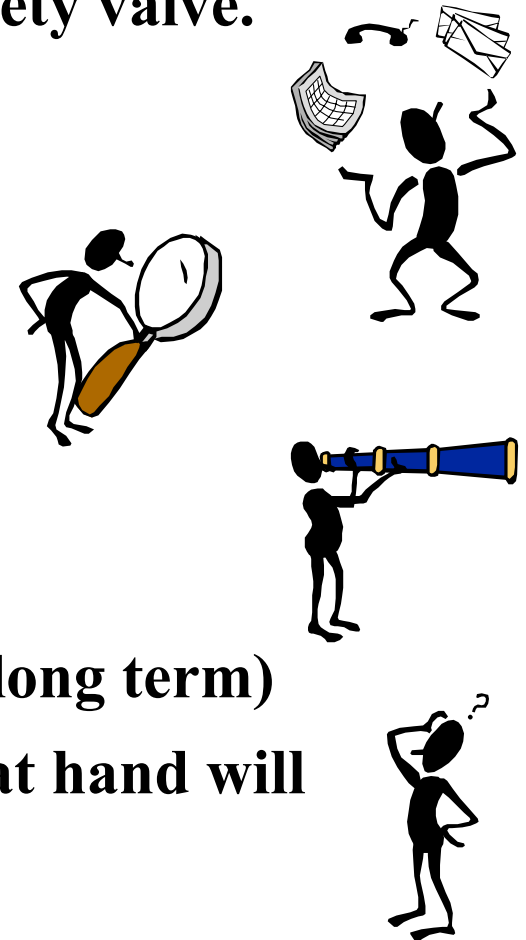
- **Having an external valve is not a safeguard**
  - No external valve will stop bad borrowing.
  - No source outside the District will work well on its own.
- **Where one can go for support, help and advice:**
  - County Office of Education
  - County Treasurer and County Auditor-Controller
  - FCMAT (available for management assistance before crisis mode)
  - District's General Counsel
  - The District's Auditor
  - District Consultants
- **The school business official must make both informed decisions and use good judgement.**

# Internal Safety Valve

■ A good business manager will create a process and use a work style which serves as an *internal* safety valve.

– This would include

- » staff research and review
- » education of board and community
- » checklists
- » commitment to process
- » attention to details
- » consideration of strategy (short and long term)
- » understanding of how the endeavor at hand will look in hindsight



# Borrowed Money Must Be Repaid



"I'd like to borrow just enough  
to get myself out of debt."



# Costs of Issuance

■ **Costs of Issuance (COI) include everything it costs to complete a financing (according to Lori Raineri)**

- Financial Advisor
- Bond Counsel
- Rating Agency
- Underwriter
- Trustee
- Bond Insurance
- Miscellaneous?
  - » Printing
  - » Shipping
  - » Travel



✓ *COI = principal - deposit to project fund + any costs billed later*

# Using the District's Four Cents



# Parties to a Securities Transaction



# Typical Cast of Characters

## ■ Financial Advisor

- Advises the borrower on the financing plan

## ■ Bond Counsel

- Gives a legal opinion on the tax-exempt status of the bonds

## ■ Rating Agency

- Provides a rating based on credit quality

## ■ Underwriter

- Brokers securities and money

## ■ Trustee

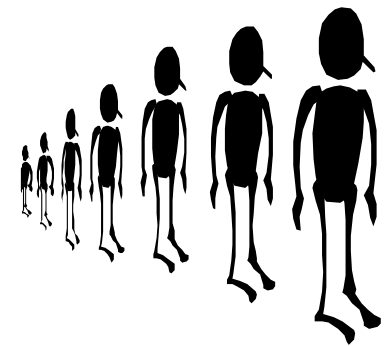
- Handles the paperwork on behalf of investors

## ■ Lender/Investor

- Widows and orphans

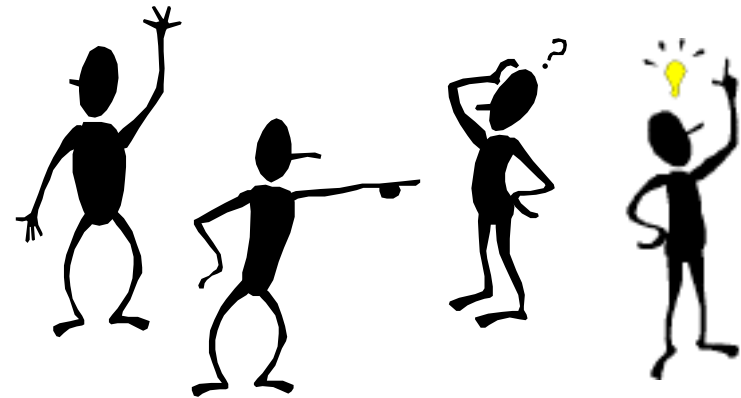
✓ *Most, if not all, of these players have a vested interest in there being a borrowing.*

- *Some have a vested interest in the terms of the borrowing that may be opposite to the District's.*

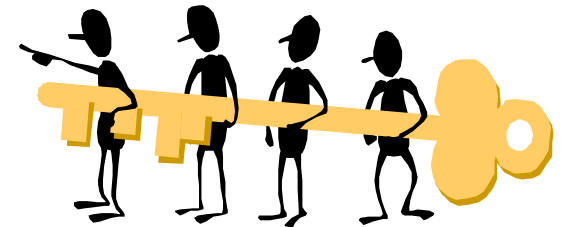


# And There Can Still Be More . . .

- Investment Advisors
- Real Estate Appraisers
- Civil Engineers
- More Lawyers
- ?



✓ *With all of these players, the team needs leadership!*



# Not All Team Members Are on the Team



# Checklist of Questions Before Issuing Debt

- ✓ **Why do you need to borrow?**
- ✓ **What type of financing will be appropriate?**
- ✓ **What is the issue size? Proposed date of issuance? Term?**
- ✓ **Does the term of the financing match the life of the asset?**
- ✓ **What is the source of funds for repayment? How consistent is this revenue stream?**
- ✓ **What about other outstanding debt? Prior defaults?**
- ✓ **Is the district growing or declining? How accurate are the ADA projections?**
- ✓ **Is there a contingency plan?**
- ✓ **Will interim financing be needed?**
- ✓ **What restrictions will come as a result?**
- ✓ **What are the ongoing administrative responsibilities?**

# Ongoing Administration

- Accounting
- Investing
- Continuing Disclosure
- Arbitrage and Rebate Regulatory Compliance
- Tax Levies
- Monitoring Refinancing Opportunities
- Supervision of subsequent activity by other parties:
  - Trustees
  - County
  - Developers
  - ?
- *The CASBO Library offers a book titled I Owe You What? or Getting a Grip on Long-Term Debt. It is worth having!*



# Lace Up Your Finances Tight!

## ■ Factors for success:

- Knowledge
- Control
- Organization
- Awareness
- Proper disclosure
- Appropriate team
- Administrative controls
  - » Good documentation
  - » Tickler system



## ■ Factors leading to failure involving debt:

- Frequent changes in personnel
- Using the wrong type of debt for the project
- Inaccurate projections leading to future shortfalls

# The District will Have to Live with the Debt

PEANUTS

BY CHARLES M. SCHULZ



# Thank You!

## ■ Questions and Comments?

